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J E I

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LDP Mulls New Taxes As Opposition Pushes For Cuts

In what is beginning to look like a replay of last year, the Diet is locked in debate over the fiscal 1988 tax plan. On one hand, the ruling Liberal Democratic Party is focusing on the need to build a solid revenue base to meet the sharply higher welfare costs expected by the end of the century. On the other, opposition parties focusing on the relatively low standard of living and already high income-tax burden call for a sizable tax cut and no new levies. Diet business has already been delayed one day over the tax issue, forcing the final lower house vote on the FY 1988 spending package to be postponed until March 10. If neither side blinks, however, the spending bill could be in jeopardy and the government may be forced to seek the equivalent of a continuing resolution, as it did last year.

Twice in the recent past the LDP has tried and failed to push major new taxes through the Diet. Prime Minister Masayoshi Ohira made a tax increase a

bend have failed. While there are those in the LDP who argue that the party must pass a new indirect tax for the long-term good of the nation, the recent loss of a by-election in Osaka for a lower house seat to a Japan Communist Party candidate who opposed any form of sales tax should serve as ample warning to Mr. Takeshita and his party.

The tax increase conundrum has become more difficult since the LDP agreed March 6 to the opposition parties' income tax cut proposal in order to end the boycott of the Diet. Thanks to extraordinary revenues and economic growth, the government may indeed be able to absorb the short-term impact of a Y2.9 trillion (\$23.2 billion) tax cut without new taxes. Over the long term, however, new revenue sources must be developed. It is not at all clear that Mr. Takeshita can succeed where others have failed before.

Jon Choy

Japanese Corporate Profits Recovering

While Japanese corporate profits are rising, the strong yen is not helping, despite some claims to the contrary. According to the Ministry of International Trade and Industry, the currency's appreciation has led to lower industrial and agricultural input prices and kept profits from falling further in fiscal 1986, but this development has been less important during the current fiscal year than the positive effects of increased production volume. The ministry notes that profit growth in export-dependent industries such as steel and electric machinery has lagged other industries by about three months.

But a new study by Fuji Bank, Ltd. appears to contradict MITI's conclusion that the soaring yen has not helped profitability, at least the profitability of domestic sales in certain industries. The bank looked at nonelectric machinery, electric machinery, precision equipment and transportation equipment and found that they have benefited from a 6.9 percent drop in the cost of fuel and raw materials since early 1985. The savings have not been fully passed on to domestic customers, however, raising the sales-to-purchase cost index (see Table). Prices to foreigners in yen, although not in dollars, have declined relative to the cost of materials and fuel. Taking foreign and domestic sales together, the effect of the higher yen has been to increase profit margins, although the higher dollar prices of exports could have reduced export volume, pulling down overall profits. Fuji Bank predicts that these four industries will face increasing competition from imports and will have to lower domestic prices in the coming months, leading to downward pressure on profits.

Some analysts have argued that for part of the period since the yen started rising, corporate income was maintained by securities trading and other financial activities, or zaitech. According to this argument, underlying profitability has actually been much worse than it appears since zaitech profits are normally unsustainable, a point driven home by the October stock market crash. While MITI does not deny that zaitech made a difference in a few cases, it suggested that the profit recovery is overwhelmingly based on other factors, especially increasing domestic sales.

Sales-to-Purchase Cost Index
for Selected Machinery Industries

(July-September 1985=100)

October-November 1987

Exports	90.8
Domestic Sales	103.5
Total Sales	100.4

Source: Fuji Bank, Ltd.

Most financial institutions and economic forecasters expect profits to keep rising throughout the economy. In a new forecast of recurring profits for firms other than financial and gas companies listed on the first section of the Tokyo Stock Exchange, Yamaichi Research Institute sees higher profits in fiscal 1987, the first increase in three years, and a further rise of 9.3 percent in FY 1988, roughly in line with many other forecasts. NRI & NCC Co., Ltd. (formerly Nomura Research Institute), for example, is forecasting a healthy 16.3 percent rise for its sample of first-section TSE firms and, within that sample, manufacturing profits are expected to surge 20 percent.

Nomura's data show that many large Japanese firms are still behind their positions prior to the rapid rise in the yen that began in the first half of fiscal year 1985, although companies in the nonmanufacturing sector are ahead (see Table). Using Nomura's forecasts, profits in the manufacturing sector will still lag behind FY 1984's a year from now.

Douglas Ostrom

Recurring Profits of Japanese Firms, FY 1985-FY 1988

(FY 1984 = 100)

	<u>FY 1985</u>	<u>FY 1986</u>	<u>FY 1987*</u>	<u>FY 1988*</u>
Manufacturing sector	74	51	76	91
Nonmanufacturing sector	95	94	103	109
All industries	80	62	83	97

*Projected by NRI & NCC Co., Ltd.

Note: Excludes electric utilities and oil companies.

Source: Calculated from data in Nomura Quarterly Economic Review.